In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 357

MIRRO-DYNAMICS CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioner is a California corporation which manufactured and sold sliding glass doors prior to April, 1961 under the names Fullview Corporation and Pacific Bolt Corporation (R. 5, 65).[1] In the spring of 1961, it sold substantially all its assets in return for over one million dollars in cash (R. 5, 71). Instead

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[1] "R." references are to the Transcript of Record in the court of appeals.

of distributing that cash to its shareholders in liquidation, petitioner opened accounts with brokers, devoted itself exclusively to buying and selling securities, and purchased over $3,000,000 of securities within a few months (R. 5, 135, 237, 282, 306, 337). From the sale of securities in 1962, the petitioner incurred losses of close to $900,000. Petitioner claimed that those losses were ordinary losses, resulting from the sale of non-capital assets, which it could carry back to the profitable years of 1959 and 1960 (R. 231). Petitioner also claimed a loss deduction for 1961, caused by repricing its closing securities "inventory" for that year, which it sought to carry back to 1958 (R. 306-307). The government's motion for summary judgment on both issues was granted by the district court and was affirmed by the court of appeals (R. 186, 286-287; Appendices A and B to Pet. 1, 6-7, 11).

The decision below is correct. There is no conflict of decisions or other occasion for review by this Court.

1. The principal question is whether petitioner's securities were capital assets as both lower courts held. Section 1221(1) of the 1954 Code provides that the term "capital asset" means "property held by the taxpayer (whether or not connected with his trade or business)" but does not include:

> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer *primarily for sale to customers in the*

ordinary course of his trade or business; * * *
[Emphasis supplied.]

The words "to customers" and "ordinary" were added to the predecessor of Section 1221(1) in 1934, Section 117, Revenue Act of 1934, c. 277, 48 Stat. 680, 714, to prevent taxpayers who actively traded in the stock market from deducting stock market losses suffered during the depression as ordinary rather than capital losses. See H. Conf. Rep. No. 1385, 73d Cong., 2d Sess., p. 22 (1939-1 Cum. Bull. (Part 2) 627, 632); S. Rep. No. 558, 73d Cong., 2d Sess., p. 12 (1939-1 Cum. Bull. (Part 2) 586, 595).[2] Consequently, courts have consistently held that loss or gain on the sale of securities by "a stock speculator trading on his own account"—whether a trader or investor—is capital in nature. *Commissioner* v. *Burnett*, 40 B.T.A. 605 (1939), affirmed in part, 118 F. 2d 659 (C.A. 5); *Van Suetendael* v. *Commissioner*, decided September 25, 1944 (P-H Memo T.C., par. 44,305), affirmed *per curiam*, 152 F. 2d

[2] Even before the Revenue Act of 1934, Congress had restricted the deduction of losses on the sale or exchange of stocks or bonds by traders or investors, by limiting the deduction of short term losses to the extent of short term gains from such transactions. See Revenue Act of 1932, c. 209, Section 23(r), 47 Stat. 179, 183; H. Rep. No. 708, 72d Cong., 1st Sess., p. 13 (1939-1 Cum. Bull. (Part 2) 457, 466); S. Rep. No. 665, 72d Cong., 1st Sess., p. 19 (1939-1 Cum. Bull. (Part 2) 496, 510); see generally, Latham, *Taxation of Capital Gains*, 23 Calif. L. Rev. 30, 34 (1934); Miller, *The "Capital Asset" Concept: A Critique of Capital Gains Taxation*, 59 Yale L. Journal 837, 844-845 (1950); American Law Institute, *Definitional Problems in Capital Gains Taxation, Discussion Draft*, pp. 330-331 (Oct. 20, 1960).

654 (C.A. 2); *Kemon* v. *Commissioner*, 16 T.C. 1026, 1032-1033 (1951) (acquiescence) 1951-2 Cum. Bull. p. 3; cf. *Faroll* v. *Jarecki*, 231 F. 2d 281 (C.A. 7), certiorari denied, 352 U.S. 830; *Commissioner* v. *Covington*, 120 F. 2d 768 (C.A. 5); *Reinach* v. *Commissioner*, 373 F. 2d 900 (C.A. 2) petition for a writ of certiorari pending, No. 292, this Term.

Petitioner, in this case, was not a member of any stock exchange, or licensed as a broker-dealer by the Securities and Exchange Commission or licensed by the State of California to sell securities to the public (R. 5, 128-130, 237, 282, 306, 337). Accordingly, it could not place buy or sell orders directly on any stock exchange or on the over-the-counter markets,[3] nor could it buy or sell securities from or to the general public.[4] On these undisputed facts,[5] the

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[3] No broker or dealer may transact interstate business on the over-the-counter markets unless registered with the Securities and Exchange Commission. Securities Exchange Act of 1934, c. 404, Sec. 5, 48 Stat. 885 (15 U.S.C., 1964 ed., Sec. 78e), and Sec. 15, as amended by Sec. 3, Act of May 27, 1936, c. 462, 49 Stat. 1377 (15 U.S.C., 1964 ed., Sec. 78o).

[4] Petitioner conducts its business in California which prohibits a corporation from engaging without a license in the business "of selling, offering for sale, negotiating for the sale of, or otherwise dealing in, any security issued by others * * * or of underwriting any issue of such securities, or of purchasing such securities with the purpose of reselling them, or of offering them for sale to the public." Corporations Code, 25 West's Anno. Calif. Code, § 25006. See also, *id.*, §§ 25700, 26104.

[5] The above facts, contained in the admissions, answers to interrogatories and depositions, were properly considered by the district court in granting a summary judgment in

court below correctly held that petitioner could not have held securities for sale "to customers" in the "ordinary" course of its business within the meaning of Section 1221(1).[6]

2. Both lower courts also correctly held that petitioner could not inventory its securities because it was not a dealer. Section 471, 1954 Code; Treasury Regulations on Income Tax (1954 Code), Sec. 1.471-5; *Schafer* v. *Helvering*, 299 U.S. 171; *Commissioner* v. *Burnett*, 118 F. 2d 659 (C.A. 5); cf. *Helvering* v. *Fried*, 299 U.S. 175; *Vaughan* v. *Commissioner*, 85 F. 2d 497 (C.A. 2).

3. Petitioner mistakenly urges (Pet. 9-13) that the rationale of this decision is inconsistent with this Court's analysis of Section 1221(1) in such cases as *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46, 52, *Commissioner* v. *Brown*, 380 U.S. 563, 572, and *Malat* v. *Riddell*, 383 U.S. 569, 571. Those cases, insofar as they are relevant here, stand for the genaral proposition that profits and losses from the everyday operation of a business are ordinary income and loss rather than capital gain and loss. We do not dis-

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favor of the government. *Burnham Chemical Co.* v. *Borax Consolidated, Ltd.*, 170 F. 2d 569, 573 (C.A. 9); *Dressler* v. *MV Sandpiper*, 331 F. 2d 130, 132 (C.A. 2).

[6] The Ninth Circuit's decision in this case makes it unnecessary to consider petitioner's request (Pet. p. 8-9) for resolution of a claimed conflict between the district court's decision in this case and a Ninth Circuit case decided over twenty years ago, *United States* v. *Chinook Investment Co.*, 136 F. 2d 984 (C.A. 9).

pute that proposition, which is based on a congressional intent not pertinent in the case of a speculator in securities. See *Corn Products*, 350 U.S. at 52; *Brown*, 380 U.S. at 570-572; *Malat*, 383 U.S. at 571-572. While there is a general legislative purpose that everyday business profit or loss be ordinary income or loss, Congress has created an exception to that general rule, as we have shown and as courts now uniformly hold, so that any loss or gain on the sale of securities held by a trader or investor—*i.e.*, one who is not a dealer who holds securities primarily for sale "to customers"—is capital loss or gain.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER, 1967

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